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FORM X-17A-5
PART III

FEB 28 2014

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FACING PAGE

Information Required of Brokers and Dealers Pursuant to Section 17 of the
Securities Exchange Act of 1934 and Rule 17a-5 ThereunderREPORT FOR THE PERIOD BEGINNING 01/01/13 AND ENDING 12/31/13
MM/DD/YY MM/DD/YY

A. REGISTRANT IDENTIFICATION

NAME OF BROKER-DEALER: Lincoln Financial Advisors Corporation

OFFICIAL USE ONLY

ADDRESS OF PRINCIPAL PLACE OF BUSINESS: (Do not use P.O. Box No.)

FIRM I.D. NO.

1300 South Clinton Street, Suite 150

(No. and Street)

Fort Wayne, Indiana 46802-3506

(City)

(State)

(Zip Code)

NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT IN REGARD TO THIS REPORT

Elizabeth F. Conover(336) 691-3153

(Area Code - Telephone Number)

B. ACCOUNTANT IDENTIFICATION

INDEPENDENT PUBLIC ACCOUNTANT whose opinion is contained in this Report*

Ernst & Young LLP

(Name - if individual, state last, first, middle name)

One Commerce Square, Suite 700, 2005 Market Street Philadelphia, PA 19103

(Address)

(City)

(State)

(Zip Code)

CHECK ONE:

- ☒ Certified Public Accountant
☐ Public Accountant
☐ Accountant not resident in United States or any of its possessions.

FOR OFFICIAL USE ONLY

*Claims for exemption from the requirement that the annual report be covered by the opinion of an independent public accountant must be supported by a statement of facts and circumstances relied on as the basis for the exemption. See Section 240.17a-5(e)(2)

SEC 1410 (06-02)

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CONSOLIDATED FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION

Lincoln Financial Advisors Corporation
Years Ended December 31, 2013 and 2012
With Report and Supplementary Report of
Independent Registered Public Accounting Firm

Ernst & Young LLP

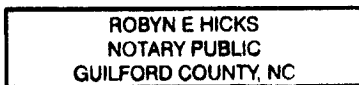
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OATH OR AFFIRMATION

I, Elizabeth F. Conover, swear (or affirm) that, to the best of my knowledge and belief the accompanying financial statement and supporting schedules pertaining to the firm of Lincoln Financial Advisors Corporation, as of December 31, 20 13, are true and correct. I further swear (or affirm) that neither the company nor any partner, proprietor, principal officer or director has any proprietary interest in any account classified solely as that of a customer, except as follows:



Elizabeth F. Conover
Signature

AVP and Interim Chief Financial Officer
Title

Robyn E. Hicks Expires 03/05/2016
Notary Public

This report ** contains (check all applicable boxes):

- ☒ (a) Facing Page.
- ☒ (b) Statement of Financial Condition.
- ☒ (c) Statement of Income (Loss).
- ☒ (d) Statement of Changes in Financial Condition.
- ☒ (e) Statement of Changes in Stockholders' Equity or Partners' or Sole Proprietors' Capital.
- ☐ (f) Statement of Changes in Liabilities Subordinated to Claims of Creditors.
- ☒ (g) Computation of Net Capital.
- ☒ (h) Computation for Determination of Reserve Requirements Pursuant to Rule 15c3-3.
- ☒ (i) Information Relating to the Possession or Control Requirements Under Rule 15c3-3.
- ☐ (j) A Reconciliation, including appropriate explanation of the Computation of Net Capital Under Rule 15c3-1 and the Computation for Determination of the Reserve Requirements Under Exhibit A of Rule 15c3-3.
- ☐ (k) A Reconciliation between the audited and unaudited Statements of Financial Condition with respect to methods of consolidation.
- ☒ (l) An Oath or Affirmation.
- ☐ (m) A copy of the SIPC Supplemental Report.
- ☐ (n) A report describing any material inadequacies found to exist or found to have existed since the date of the previous audit.

**For conditions of confidential treatment of certain portions of this filing, see section 240.17a-5(e)(3).

Lincoln Financial Advisors Corporation
Consolidated Financial Statements and Supplementary Information
Years Ended December 31, 2013 and 2012

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Report of Independent Registered Public Accounting Firm

The Board of Directors
Lincoln Financial Advisors Corporation

We have audited the accompanying consolidated financial statements of Lincoln Financial Advisors Corporation (an indirect, wholly owned subsidiary of Lincoln National Corporation) (the "Company"), which comprise the consolidated statements of financial condition as of December 31, 2013 and 2012, and the related consolidated statements of income, changes in stockholder's equity, and cash flows for the years then ended that are filed pursuant to Rule 17a-5 under the Securities Exchange Act of 1934, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.



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We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Lincoln Financial Advisors Corporation as of December 31, 2013 and 2012, and the consolidated results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The information contained in Schedules I, II, and III is presented for purposes of additional analysis and is not a required part of the financial statements, but is supplementary information required by Rule 17a-5 under the Securities Exchange Act of 1934. Such information is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

February 25, 2014

Ernst & Young LLP

Lincoln Financial Advisors Corporation

Consolidated Statements of Financial Condition

	December 31	
	2013	2012
Assets		
Cash and invested cash	\$ 45,815,596	\$ 36,354,489
Cash segregated for regulatory purposes	10,000,000	6,430,000
Commissions and fees receivable	48,065,829	42,341,171
Due from affiliates	4,904,951	2,400,808
Deferred tax asset	7,046,536	8,166,825
Prepaid expenses	1,352,077	1,316,749
Other assets, cash invested with affiliate	10,669,352	9,777,329
Other assets	28,104,833	5,393,097
Net property and equipment (accumulated depreciation: 2013 – \$4,476,016; 2012 – \$4,267,155)	4,291,358	1,078,122
Total assets	\$ 160,250,532	\$ 113,258,590
Liabilities and stockholder's equity		
Liabilities:		
Payable to vendors	\$ 1,006,552	\$ 431,331
Due to affiliates	22,104,303	16,956,161
Deferred revenue	2,707,725	3,246,936
Accrued commissions	29,797,747	25,424,977
Accrued compensation and benefits	11,058,373	9,514,344
Other liabilities	24,450,244	7,598,055
Total liabilities	91,124,944	63,171,804
Stockholder's equity:		
Common stock – \$100 par value; 5,000 shares authorized, issued, and outstanding	500,000	500,000
Additional paid-in capital	19,923,598	19,746,694
Retained earnings	48,701,990	29,840,092
Total stockholder's equity	69,125,588	50,086,786
Total liabilities and stockholder's equity	\$ 160,250,532	\$ 113,258,590

See accompanying notes.

Lincoln Financial Advisors Corporation

Consolidated Statements of Income

	Year Ended December 31	
	2013	2012
Revenues:		
Commissions and fees from third parties	\$ 311,516,769	\$ 271,532,997
Commissions and fees from affiliates	130,458,653	117,095,965
Other	493,373	555,841
Interest	50,825	89,353
Total revenues	442,519,620	389,274,156
Expenses:		
Commissions and agency expenses	292,284,478	251,445,165
Service charges from affiliates	82,327,908	75,310,416
Salaries, wages, and benefits	24,340,890	23,843,269
Licenses and fees	2,166,268	1,564,890
Professional and legal	3,455,281	6,818,803
Office expenses	6,154,922	3,926,152
Other general and administrative expenses	707,358	4,837,789
Total expenses	411,437,105	367,746,484
Income before income tax expense	31,082,515	21,527,672
Income tax expense	12,220,617	8,453,190
Net income	\$ 18,861,898	\$ 13,074,482

See accompanying notes.

Lincoln Financial Advisors Corporation

Consolidated Statements of Changes in Stockholder's Equity

	Year Ended December 31	
	2013	2012
Common stock:		
Balance as of beginning and end of year	<u>\$ 500,000</u>	<u>\$ 500,000</u>
Additional paid-in capital:		
Balance as of beginning of year	19,746,694	16,753,317
Share-based payment expense	<u>176,904</u>	<u>2,993,377</u>
Balance as of end of year	<u>19,923,598</u>	<u>19,746,694</u>
Retained earnings:		
Balance as of beginning of year	29,840,092	36,765,610
Net income	18,861,898	13,074,482
Dividends paid	—	(20,000,000)
Balance as of end of year	<u>48,701,990</u>	<u>29,840,092</u>
Total stockholder's equity as of end of year	<u><u>\$ 69,125,588</u></u>	<u><u>\$ 50,086,786</u></u>

See accompanying notes.

Lincoln Financial Advisors Corporation

Consolidated Statements of Cash Flows

	Year Ended December 31	
	2013	2012
Operating activities		
Net income	\$ 18,861,898	\$ 13,074,482
Adjustments to reconcile net income to net cash provided by operating activities:		
Change in deferred tax asset	1,451,259	581,872
Depreciation on property and equipment	208,861	171,571
Share-based payment expense	(154,065)	1,522,192
Change in cash segregated for regulatory purposes	(3,570,000)	—
Change in commissions and fees receivable	(5,724,658)	(4,495,462)
Change in due from affiliates	(2,504,143)	(1,489,676)
Change in prepaid expenses	(35,328)	(180,340)
Change in other assets, cash invested with affiliate	(892,023)	53,434
Change in other assets	(22,711,736)	94,611
Change in payable to vendors	575,221	(136,108)
Change in due to affiliates	5,148,142	2,482,693
Change in deferred revenue	(539,211)	295,854
Change in accrued commissions	4,372,770	2,369,796
Change in accrued compensation and benefits	1,544,029	1,488,728
Change in other liabilities	16,852,189	(968,845)
Net cash provided by operating activities	12,883,205	14,864,802
Investing activities		
Purchase of property and equipment	(3,422,098)	(406,872)
Net cash used in investing activities	(3,422,098)	(406,872)
Financing activities		
Dividends paid to stockholder	—	(20,000,000)
Net cash used in financing activities	—	(20,000,000)
Net increase (decrease) in cash and invested cash	9,461,107	(5,542,070)
Cash and invested cash as of beginning of year	36,354,489	41,896,559
Cash and invested cash as of end of year	<u>\$ 45,815,596</u>	<u>\$ 36,354,489</u>
Supplemental disclosure of cash flow information		
Income tax payments	<u>\$ 12,636,405</u>	<u>\$ 8,865,538</u>
Noncash transactions		
Executive stock option tax benefit	<u>\$ 330,973</u>	<u>\$ 1,469,185</u>

See accompanying notes.

Lincoln Financial Advisors Corporation

Notes to Consolidated Financial Statements

December 31, 2013

1. Nature of Operations, Basis of Presentation, and Summary of Significant Accounting Policies

Nature of Operations

Lincoln Financial Advisors Corporation (“LFA” or the “Company,” which also may be referred to as “we,” “our,” or “us”) is a registered broker-dealer and investment advisor engaged principally in the distribution of securities, including certain mutual funds, limited partnerships, and equity and fixed income securities. LFA is licensed to engage in broker-dealer and investment advisor activity throughout the United States. Our wholly owned subsidiary, LFA Management Corporation (“LFAMC”) is a management company incorporated in 2004 for the purpose of providing LFA with executive management services and corporate governance. LFA is a wholly owned subsidiary of The Lincoln National Life Insurance Company (“LNL”), which is a wholly owned subsidiary of Lincoln National Corporation (“LNC”).

Basis of Presentation

The accompanying consolidated financial statements are prepared in accordance with United States of America generally accepted accounting principles (“GAAP”). Certain GAAP policies, which significantly affect the determination of financial position, results of operations, and cash flows, are summarized below.

Summary of Significant Accounting Policies

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of LFA and its wholly owned subsidiary, LFAMC. All intercompany accounts and transactions have been eliminated in consolidation.

The Company and other affiliated entities that provide services to the Company are under common ownership and management control. The existence of this control could result in the Company’s operating results or financial position being significantly different from those that would have been obtained if the Company were autonomous.

Lincoln Financial Advisors Corporation

Notes to Consolidated Financial Statements (continued)

1. Nature of Operations, Basis of Presentation, and Summary of Significant Accounting Policies (continued)

Accounting Estimates and Assumptions

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions affecting the reported amounts of assets and liabilities and the disclosures of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses for the reporting period. Those estimates are inherently subject to change, and actual results could differ from those estimates.

Cash and Invested Cash

Cash and invested cash is carried at cost and includes all highly liquid investments purchased with an original maturity of three months or less. Cash of \$10,000,000 and \$6,430,000 as of December 31, 2013 and 2012, respectively, has been segregated in a special restricted bank account for the benefit of customers under Rule 15c3-3 of the Securities Exchange Act of 1934.

Cash Invested With Affiliate

In order to manage capital more efficiently, the Company participates in an intercompany cash management program where LNC can lend to or borrow from the Company to meet short-term borrowing needs. The cash management program is essentially a series of demand loans among LNC and its affiliates that reduces the overall borrowing costs by allowing LNC and its affiliates to access internal resources instead of incurring third-party transaction costs. Invested cash with LNC was \$10,669,352 and \$9,777,329 at December 31, 2013 and 2012, respectively, and is included in other assets, cash invested with affiliate on the Consolidated Statements of Financial Condition.

Commission Revenue and Expense

Commission revenue for customer securities transactions and related commission expenses are recorded on a settlement-date basis, which does not deviate materially from a trade-date basis. Asset-based revenue and related commission expenses are recorded as earned based on a contractual percentage of customer deposits. Wrap fee income, also referred to as assets under management fee income, is received one quarter in arrears on a number of programs in which LFA participates. An accrual is recorded for fee income, and a corresponding accrual is recorded for the commission expense to be paid based on the fee income.

Lincoln Financial Advisors Corporation

Notes to Consolidated Financial Statements (continued)

1. Nature of Operations, Basis of Presentation, and Summary of Significant Accounting Policies (continued)

Income Taxes

LNC files a U.S. consolidated income tax return that includes all eligible subsidiaries, including LFA and LNL. Pursuant to an intercompany tax-sharing agreement with LNL, LFA provides for income taxes on a separate return filing basis. The tax-sharing agreement also provides that LFA will receive benefit for net operating losses, capital losses, and tax credits, which may not be usable on a separate return basis to the extent such items may be utilized in the consolidated federal income tax returns of LNC.

Deferred income taxes are recognized, based on enacted rates, when assets and liabilities have different values for financial statement and tax reporting purposes. A valuation allowance is recorded to the extent required. Considerable judgment and the use of estimates are required in determining whether a valuation allowance is necessary and, if so, the amount of such valuation allowance. See Note 3 for additional information.

Revenues, Expenses, Other Assets, and Other Liabilities Related to AdviceNextSM

As discussed in Note 2, the Company entered into an agreement with the Company's clearing provider to launch *AdviceNextSM*. The agreement provides for business development credits that are received by the Company from the clearing provider upon execution of the contract and achievement of certain time or performance milestones, as specified in the contract. The business development credits are recorded as deferred revenue and are being recognized over the contract period in other income on the Consolidated Statements of Income.

The launch of *AdviceNextSM* results in incremental and identifiable costs that are directly related to the acquisition of the agreement with the clearing provider. These costs have been capitalized and will be amortized over the contract period in other general and administrative expenses on the Consolidated Statements of Income.

Lincoln Financial Advisors Corporation

Notes to Consolidated Financial Statements (continued)

1. Nature of Operations, Basis of Presentation, and Summary of Significant Accounting Policies (continued)

Property and Equipment

Property and equipment owned for company use is carried at cost less allowances for depreciation. Provisions for depreciation are computed on the straight-line method over the estimated useful lives of the assets, which include furniture and fixtures, leasehold improvements, data processing equipment, and computer software. As of December 31, 2013, there were capitalized internal use software development costs of \$2,702,165 related to *AdviceNextSM*. See Note 2 for additional information. There was no accumulated depreciation for the year ended December 31, 2013, as the entire balance was work-in-progress.

Deferred Revenue

Cash received in advance for financial planning contracts is recorded as deferred revenue until delivery of the financial plan to the respective customer.

Deferred Compensation

Certain LFA employees participate in a deferred compensation plan sponsored and administered by LNC. LFA is allocated appropriate expenses related to the plan by LNC. LFA reports current period expense in salaries, wages, and benefits on the Consolidated Statements of Income with the liability in accrued compensation and benefits on the Consolidated Statements of Financial Condition.

Stock-Based Compensation

Certain LFA employees participate in stock-based compensation programs sponsored and administered by LNC. LFA is allocated appropriate expenses related to the program by LNC. LFA reports current period expense in salaries, wages, and benefits on the Consolidated Statements of Income with the nonexercised portion in accrued compensation and benefits on the Consolidated Statements of Financial Condition.

Lincoln Financial Advisors Corporation

Notes to Consolidated Financial Statements (continued)

1. Nature of Operations, Basis of Presentation, and Summary of Significant Accounting Policies (continued)

Loans to Registered Representatives

LFA has a loan program to attract top-producing representatives to join the sales network. Assuming the producers can generate gross dealer concessions (“GDC”) in excess of a contracted amount, LFA will advance the representative a specified dollar amount that will be forgiven over the life of the loan (typically three to seven years). The executed contract for each loan stipulates annual GDC requirements that must be met in order for that year’s proportion of the loan to be waived. Alternatively, if at the end of the contract period, the cumulative GDC production is equal to or in excess of the aggregate contract requirement, the entire balance of the loan will be waived. The net loan receivable is reported in other assets on the Consolidated Statements of Financial Condition.

2. Launch of *AdviceNext*SM

Effective September 30, 2013, Lincoln Financial Network (“LFN”), the retail wealth management affiliate of LNC and the marketing name for LFA and Lincoln Financial Securities Corporation (“LFS”), a broker-dealer affiliate, entered into an agreement with LFN’s clearing provider to launch *AdviceNext*SM, a new integrated offering that optimizes the delivery of the firm’s practice resources, tools, and technology to advisors. This initiative requires a significant, multi-year investment and is also being supported by significant platform investment by the Company’s clearing provider.

The agreement provides for business development credits that are received by the Company from the clearing provider upon execution of the contract and achievement of certain time or performance milestones, as specified in the contract. The agreement also provides for the repayment of the business development credits under certain circumstances, including if LFN does not meet minimum client account asset levels or if LFN terminates the contract prior to its contractual end date, September 30, 2025. LFN allocated the business development credits to LFA and LFS accordingly. LFA was allocated \$23,610,000 in business development credits and received \$10,200,000 in 2013. LFA reports the remaining \$13,410,000 in business development credits receivable in other assets on the Consolidated Statements of Financial Condition. The business development credits are recorded as deferred revenue and will be recognized over the contract period. LFA recognized \$492,188 in revenue related to the business development credits in 2013, and as of December 31, 2013, reported \$23,117,812 of deferred revenue in other liabilities on the Consolidated Statements of Financial Condition.

Lincoln Financial Advisors Corporation

Notes to Consolidated Financial Statements (continued)

2. Launch of *AdviceNext*SM (continued)

The launch of *AdviceNext*SM results in incremental and identifiable costs that are directly related to the acquisition of the agreement, with the clearing provider, that would not have been incurred but for the acquisition of the agreement and qualify for capitalization. LFA capitalized \$8,805,142 in costs in 2013, which will be amortized over the contract period. LFA amortized \$171,612 in costs in 2013. LFA expects the total incremental and identifiable costs incurred to launch *AdviceNext*SM to approximate the business development credits provided by the Company's clearing provider.

In addition to the capitalized costs described above, the Company capitalized \$2,702,165 of internal use software development costs related to *AdviceNext*SM. There was no accumulated depreciation for the year ended December 31, 2013, as the entire balance was work-in-progress.

3. Income Taxes

The income tax expense was as follows:

	Year Ended December 31	
	2013	2012
Federal income tax expense:		
Current	\$ 9,018,582	\$ 6,342,679
Deferred	1,290,846	567,175
Federal income tax expense	10,309,428	6,909,854
State income tax expense:		
Current	1,750,776	1,528,639
Deferred	160,413	14,697
State income tax expense	1,911,189	1,543,336
Total income tax expense	\$ 12,220,617	\$ 8,453,190

Lincoln Financial Advisors Corporation

Notes to Consolidated Financial Statements (continued)

3. Income Taxes (continued)

A reconciliation of the effective tax rate differences was as follows:

	Year Ended December 31	
	2013	2012
Tax rate times pretax income	\$ 10,878,880	\$ 7,534,685
Effect of:		
State tax expenses	1,242,272	1,003,168
Other items	99,465	(84,663)
Income tax expense	\$ 12,220,617	\$ 8,453,190
Effective tax rate	39.32%	39.27%

The effective tax rate is the ratio of tax expense over pretax income (loss). Other items include permanent adjustments.

The income tax asset was as follows:

	Year Ended December 31	
	2013	2012
Federal income tax asset:		
Current	\$ 3,066,099	\$ 1,212,605
Deferred	5,394,450	6,410,029
Federal income tax asset	8,460,549	7,622,634
State income tax asset:		
Current	135,554	121,698
Deferred	1,652,086	1,756,796
State income tax asset	1,787,640	1,878,494
Total current income tax receivable	3,201,653	1,334,303
Total deferred income tax asset	\$ 7,046,536	\$ 8,166,825

Lincoln Financial Advisors Corporation

Notes to Consolidated Financial Statements (continued)

3. Income Taxes (continued)

Significant components of our deferred tax assets and liabilities were as follows:

	Year Ended December 31	
	2013	2012
Deferred tax assets		
Employee compensation plans	\$ 5,833,272	\$ 5,506,388
Accrued liabilities	416,701	1,209,926
Other	796,563	1,450,511
Total deferred tax assets	<u>7,046,536</u>	<u>8,166,825</u>
Deferred tax liabilities		
Total deferred tax liabilities	—	—
Net deferred tax asset	<u>\$ 7,046,536</u>	<u>\$ 8,166,825</u>

Current federal income taxes receivable is included in due from affiliates on the Consolidated Statements of Financial Condition. Current state income taxes receivable is included in other assets on the Consolidated Statements of Financial Condition.

The Company is required to establish a valuation allowance for any gross deferred tax assets that are unlikely to reduce taxes payable in future years' tax returns. At December 31, 2013 and 2012, the Company concluded that it was more likely than not that its gross deferred tax assets will reduce taxes payable in future years; therefore, no valuation allowance was necessary. The LNC consolidated group is subject to annual tax examinations from the Internal Revenue Service ("IRS") and state taxing jurisdictions. We do not anticipate that any adjustments that might result from such audits would be material to our consolidated results of operations or financial condition. The LNC consolidated group is currently under audit by the IRS for years 2009, 2010, and 2011.

There are no uncertain tax positions related to the Company in the current year.

Lincoln Financial Advisors Corporation

Notes to Consolidated Financial Statements (continued)

4. Agreements and Transactions With Affiliates

In order to be compliant with the Financial Industry Regulatory Authority ("FINRA") rules regarding proper expense recognition and expense-sharing agreements and to better match expenses with related securities revenue, LFA has entered into various cost-sharing agreements with affiliates. Salary, benefit, and travel ("HR") costs for a number of affiliate employees who provide substantial service to LFA have been identified and allocated to LFA. LFA employees have also been identified who provide substantial service to affiliates for which HR costs were allocated from LFA to those affiliates. The net impact to LFA in this effort was additional expense of \$2,511,192 in 2013 and 2012, which is reported primarily in salaries, wages, and benefits expense on the Consolidated Statements of Income.

Service charges for securities-related expenses are allocated pursuant to a Master Services Agreement and include, but are not limited to, costs related to officer compensation and benefits, compliance services, home and field office, and administrative expenses. These expenses are identified and charged to LFA on a monthly basis by the affiliated agency companies. LFA incurred \$80,621,921 and \$73,565,439 of allocated securities-related service charges in 2013 and 2012, respectively, which are reported in service charges from affiliates on the Consolidated Statements of Income.

LFA also has a similar Master Services Agreement with LNL's Retirement Planning Services ("RPS") division. Costs related to the sale of RPS products that result in LFA revenue are identified and allocated to LFA as service charges on a monthly basis by RPS. LFA incurred \$1,705,987 and \$1,744,977 of RPS-related service charges in 2013 and 2012, respectively, which is reported in service charges from affiliates on the Consolidated Statements of Income.

Service charges are allocated to LFA by certain affiliates under common LNC control for corporate and administrative services and for certain securities-related and product-specific expenses pursuant to Master Services Agreements. Service charges for corporate and administrative services include, but are not limited to, costs related to human resource administration, print and distribution, legal services, compliance, information technology, and communication services. Total affiliate corporate and administrative service charge allocations were \$6,799,156 and \$7,496,842 in 2013 and 2012, respectively, which are reported in general and administrative expenses, including salaries, wages, and benefits, professional and legal, office expenses, and other general and administrative expenses on the Consolidated Statements of Income.

Lincoln Financial Advisors Corporation

Notes to Consolidated Financial Statements (continued)

5. Contingencies and Commitments

Contingencies

Regulatory and Litigation Matters

Regulatory bodies, such as the Securities and Exchange Commission (“SEC”), FINRA, and other regulatory bodies, regularly make inquiries and conduct examinations or investigations concerning our compliance with, among other things, securities laws, laws governing the activities of broker-dealers, and registered investment advisors.

LFA is involved in various pending or threatened legal or regulatory proceedings arising from the conduct of business both in the ordinary course and otherwise. In some of the matters, very large and/or indeterminate amounts, including punitive and treble damages, are sought. Modern pleading practice in the U.S. permits considerable variation in the assertion of monetary damages or other relief. Jurisdictions may permit claimants not to specify the monetary damages sought or may permit claimants to state only that the amount sought is sufficient to invoke the jurisdiction of the trial court. In addition, jurisdictions may permit plaintiffs to allege monetary damages in amounts well exceeding reasonably possible verdicts in the jurisdiction for similar matters. This variability in pleadings, together with our actual experiences in litigating or resolving through settlement numerous claims over an extended period of time, demonstrates to management that the monetary relief that may be specified in a lawsuit or claim bears little relevance to its merits or disposition value.

Due to the unpredictable nature of litigation, the outcome of a litigation matter and the amount or range of potential loss at particular points in time are normally difficult to ascertain. Uncertainties can include how fact finders will evaluate documentary evidence and the credibility and effectiveness of witness testimony, and how trial and appellate courts will apply the law in the context of the pleadings or evidence presented, whether by motion practice, or at trial or on appeal. Disposition valuations are also subject to the uncertainty of how opposing parties and their counsel will themselves view the relevant evidence and applicable law.

Lincoln Financial Advisors Corporation

Notes to Consolidated Financial Statements (continued)

5. Contingencies and Commitments (continued)

We establish liabilities for litigation and regulatory loss contingencies when information related to the loss contingencies shows both that it is probable that a loss has been incurred and the amount of the loss can be reasonably estimated. It is possible that some matters could require us to pay damages or make other expenditures or establish accruals in amounts that could not be estimated as of December 31, 2013. While the potential future charges could be material in the particular quarterly or annual periods in which they are recorded, based on information currently known by management, management does not believe any such charges are likely to have a material adverse effect on LFA's consolidated financial position.

For some matters, the Company is able to estimate a reasonably possible range of loss. For such matters in which a loss is probable, an accrual has been made. For such matters where a loss is believed to be reasonably possible, but not probable, no accrual has been made. For other matters, we are not currently able to estimate the reasonably possible loss or range of loss. We are often unable to estimate the possible loss or range of loss until developments in such matters have provided sufficient information to support an assessment of the range of possible loss, such as quantification of a damage demand from plaintiffs, discovery from other parties and investigation of factual allegations, rulings by the court on motions or appeals, analysis by experts, and the progress of settlement negotiations. On a quarterly and annual basis, we review relevant information with respect to litigation contingencies and update our accruals, disclosures, and estimates of reasonably possible losses or ranges of loss based on such reviews.

Commitments

LFA has entered into loan agreements with select groups of registered representatives in which the principal balances loaned are determined by specific, agreed-upon operating expenses incurred by the groups while conducting business over a period specified within each agreement. Under these agreements, the borrowers may obtain advances to pay for expenses incurred up to but not exceeding agreed-upon amounts. The total principal balance of these loans is \$5,893,559 and \$5,121,750 at December 31, 2013 and 2012, respectively, which is reported in other assets on the Consolidated Statements of Financial Condition. The remaining commitment by LFA to advance funds is \$466,599 and \$478,250 at December 31, 2013 and 2012, respectively.

Lincoln Financial Advisors Corporation

Notes to Consolidated Financial Statements (continued)

6. Net Capital Requirements

LFA is subject to the SEC Uniform Net Capital Rule (Rule 15c3-1), which requires the maintenance of minimum net capital and requires that the ratio of aggregate indebtedness to net capital, both as defined by Rule 15c3-1, may not exceed 15 to 1.

	Year Ended December 31	
	2013	2012
Minimum net capital requirement	\$ 5,462,248	\$ 3,701,847
Net capital	19,715,776	14,932,553
Excess net capital	<u>\$ 14,253,528</u>	<u>\$ 11,230,706</u>
Aggregate indebtedness	<u>\$ 81,933,683</u>	<u>\$ 55,527,678</u>
Ratio of aggregate indebtedness to net capital	<u>4.16 to 1</u>	<u>3.72 to 1</u>

7. Subsequent Events

The Company has evaluated subsequent events for recognition and disclosure through the date the financial statements were issued.

Supplementary Information

Lincoln Financial Advisors Corporation

Schedule I – Computation of Net Capital Pursuant to Rule 15c3-1 under the Securities Exchange Act of 1934

December 31, 2013

Computation of net capital

Consolidated stockholder's equity	\$ 69,125,588
Deduct subsidiary's stockholder's equity	<u>8,067,139</u>
Total stockholder's equity qualified for net capital	61,058,449
Less non-allowable assets:	
Commissions and fees receivable	15,724,574
Receivables from affiliates	4,858,147
Deferred tax asset	540,474
Prepaid expenses	1,352,077
Other assets	14,187,869
Property and equipment	<u>4,280,926</u>
Total non-allowable assets	40,944,067
Other deductions	<u>2,124</u>
Net capital before haircuts on securities positions	20,112,258
Haircuts on securities	<u>396,482</u>
Net capital	<u><u>\$ 19,715,776</u></u>

Computation of aggregate indebtedness

Total aggregate indebtedness	<u><u>\$ 81,933,683</u></u>
Ratio aggregate indebtedness to net capital	<u><u>4.16 to 1</u></u>

Computation of basic net capital requirements

Net capital requirement (greater of 6 2/3% of aggregate indebtedness or \$250,000)	<u><u>\$ 5,462,248</u></u>
Excess net capital	<u><u>\$ 14,253,528</u></u>
Net capital less the greater of 10% aggregate indebtedness or 120% of \$250,000	<u><u>\$ 11,522,408</u></u>

The audited financial statements are presented on a consolidated basis; however, the accompanying net capital calculation is presented based on LFA's unconsolidated financial information. No material differences exist between the above computation of net capital and the computation included in the Company's corresponding amended unaudited Form X-17A-5, Part II filing as of December 31, 2013 submitted, on February 24, 2014.

Lincoln Financial Advisors Corporation

Schedule II – Computation for Determination of Reserve Requirements
Pursuant to Rule 15c3-3 under the Securities Exchange Act of 1934

December 31, 2013

Credit balances

Free credit and other credit balances	\$ 2,737,256
Total credit items	<u>2,737,256</u>

Debit balances

Secured customer debit balances	—
Less 1%	<u>—</u>
Total debit items	<u>—</u>
Excess of total credits over total debits	<u>\$ 2,737,256</u>

Amount held on deposit in “Reserve Bank Account” at end of reporting period	\$ 10,000,000
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Amount of deposit made on January 3, 2014	<u>3,000,000</u>
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New amount in “Reserve Bank Account” after adding deposit	<u>\$ 13,000,000</u>
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No material differences exist between the above computation and the computation included in the Company’s corresponding amended unaudited Form X-17A-5, Part II filing as of December 31, 2013, submitted on February 24, 2014.

Supplementary Report



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Supplementary Report of Independent Registered Public Accounting Firm on Internal Control Required by SEC Rule 17a-5(g)(1)

The Board of Directors
Lincoln Financial Advisors Corporation

In planning and performing our audit of the consolidated financial statements of Lincoln Financial Advisors Corporation (the "Company"), as of and for the year ended December 31, 2013, in accordance with auditing standards generally accepted in the United States, we considered its internal control over financial reporting ("internal control") as a basis for designing our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control.

Also, as required by Rule 17a-5(g)(1) of the Securities and Exchange Commission ("SEC"), we have made a study of the practices and procedures followed by the Company, including consideration of control activities for safeguarding securities. This study included tests of compliance with such practices and procedures that we considered relevant to the objectives stated in Rule 17a-5(g), including the following:

1. Making the periodic computations of aggregate indebtedness (or aggregate debits) and net capital under Rule 17a-3(a)(11) and the reserve required by Rule 15c3-3(e)
2. Making the quarterly securities examinations, counts, verifications and comparisons and the recordation of differences required by Rule 17a-13
3. Complying with the requirements for prompt payment for securities under Section 8 of Federal Reserve Regulation T of the Board of Governors of the Federal Reserve System
4. Obtaining and maintaining physical possession or control of all fully paid and excess margin securities of customers as required by Rule 15c3-3

The management of the Company is responsible for establishing and maintaining internal control and the practices and procedures referred to in the preceding paragraph. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of controls, and of the practices and procedures referred to in the preceding paragraph, and to assess whether those practices and procedures can be expected to achieve the SEC's above-mentioned objectives. Two of the objectives of internal control and the practices and procedures are to provide management with reasonable but not absolute assurance that assets for which the Company has responsibility are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with



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management's authorization and recorded properly to permit the preparation of financial statements in conformity with generally accepted accounting principles. Rule 17a-5(g) lists additional objectives of the practices and procedures listed in the preceding paragraph.

Because of inherent limitations in internal control and the practices and procedures referred to above, error or fraud may occur and not be detected. Also, projection of any evaluation of them to future periods is subject to the risk that they may become inadequate because of changes in conditions or that the effectiveness of their design and operation may deteriorate.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control was for the limited purpose described in the first and second paragraphs and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control and control activities for safeguarding securities that we consider to be material weaknesses as defined above.

We understand that practices and procedures that accomplish the objectives referred to in the second paragraph of this report are considered by the SEC to be adequate for its purposes in accordance with the Securities Exchange Act of 1934 and related regulations and that practices and procedures that do not accomplish such objectives in all material respects indicate a material inadequacy for such purposes. Based on this understanding and on our study, we believe that the Company's practices and procedures, as described in the second paragraph of this report, were adequate at December 31, 2013, to meet the SEC's objectives.

This report is intended solely for the information and use of the Board of Directors, management, the SEC, FINRA and other regulatory agencies that rely on Rule 17a-5(g) under the Securities Exchange Act of 1934 in their regulation of registered brokers and dealers, and other recipients specified by Rule 17a-5(d)(6) and is not intended to be and should not be used by anyone other than these specified parties.

Ernst + Young LLP

February 25, 2014

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